

# Supplemental Guidelines to California Adjustments

## General Information

In general California tax law conforms to the Internal Revenue Code (IRC) as of January 1, 1998. However, there are continuing differences between California and federal tax law. California has not conformed to most of the changes made to the IRC by the Federal Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (Public Law 105-206) and has not conformed to any of the changes made by the Tax and Trade Relief Extension Act of 1998 (Public Law 105-277).

## Purpose

Use these guidelines to make adjustments to federal adjusted gross income that are necessary because of current year or prior year differences between California and federal law. Generally, you report these adjustments directly on Schedule CA (540), California Adjustments — Residents (or Schedule CA (540NR), California Adjustments — Nonresidents or Part-Year Residents).

If you are required to make multiple adjustments for any one line on Schedule CA (540 or 540NR), attach a schedule to your return summarizing these adjustments.

In some cases you need to complete other forms or schedules to figure the adjustment to carry to Schedule CA (540 or 540NR). See "Order Forms" on the back cover of your tax booklet for information about ordering forms.

| ITEM   | DIFFERENCES BETWEEN FEDERAL AND CALIFORNIA LAW  | WHAT TO DO FOR CALIFORNIA  |
|--|---|--|
| <b>Wages, Salaries, Tips, etc.</b>   |   |  |
| <ul style="list-style-type: none"> <li>Military pay</li> </ul>   | Special rules apply to active duty military pay.  | Get FTB Pub. 1032 for more information.  |
| <ul style="list-style-type: none"> <li>Sick pay received under the Federal Insurance Contributions Act and Railroad Retirement Act</li> </ul>          | California excludes from income the sick pay received under these Acts.   | Enter qualifying sick pay included in federal income on Schedule CA (540 or 540NR), line 7, column B.  |
| <ul style="list-style-type: none"> <li>Income exempted by U.S. treaties</li> </ul>   | Income exempted by treaty under federal law may be excluded for California only if the treaty specifically excludes the income for state purposes.  | Enter the amount excluded from federal income on Schedule CA (540 or 540NR), line 7, column C.   |
| <ul style="list-style-type: none"> <li>Employee income exclusions for ridesharing programs</li> </ul>  | Current federal law provides an income exclusion for the value of parking provided to an employee up to \$170 per month and for transit passes provided to an employee up to \$65 per month.<br><br>California law provides an income exclusion (for years beginning on or after 1/1/88) for compensation or the fair market value of other benefits (except for salary or wages) received for participation in a California ridesharing arrangement (subsidized parking, commuting in a third-party vanpool, a private commuter bus, a subscription taxipool, and monthly transit passes provided for employees and their dependents). The exclusion is not available for passes for dependents who are elementary or secondary school students. | Enter the amount of ridesharing benefits received and included in federal income on Schedule CA (540 or 540NR), line 7, column B.  |
| <ul style="list-style-type: none"> <li>California Qualified Stock Options (CQSOs)</li> </ul>   | California law provides an income exclusion for California qualified stock options (issued after 1/1/97 and before 1/1/2000) that are exercised by an individual who has earned income for the taxable year from the corporation granting the CQSO of \$40,000 or less; and has exercised options for no more than 1,000 shares with a combined fair market value of less than \$100,000 (determined at the time the options are granted).  | Enter on Schedule CA (540 or 540NR), line 7, column B the amount included in federal income that qualifies for the California exclusion.   |
| <ul style="list-style-type: none"> <li>Employer-provided meals</li> </ul>  | Federal law allows employees to exclude from fringe benefits the value of meals provided by their employer at the job site for the employer's convenience if the meals were provided to more than 50% of the employees. California law has not conformed to this provision which allows the exclusion solely because the meals were provided to more than 50% of the employees.   | Check with your employer to see if this applies to you. If it does, enter the amount of benefits excluded from federal income on Schedule CA (540 and 540NR), line 7, column C.  |
| <b>Taxable Interest Income</b>   |   |  |
| <ul style="list-style-type: none"> <li>Non-California bonds:               <ol style="list-style-type: none"> <li>United States</li> </ol> </li> </ul> | Federal law requires including in gross income the interest earned on federal bonds (U.S. obligations). California does not tax this interest income. The following are not considered U.S. obligations for California purposes: Federal National Mortgage Association (Fannie Mae); Government National Mortgage Association (Ginnie Mae); or Federal Home Loan Mortgage Corporation (Freddie Mac).  | Enter the amount of federal bond interest included in federal income on Schedule CA (540 or 540NR), line 8, column B.  |
| <ul style="list-style-type: none"> <li> <ol style="list-style-type: none"> <li>Other states</li> </ol> </li> </ul>                                     | Federal law does not tax interest from state or local bonds. California taxes the interest from non-California state and local bonds.   | Enter the interest from non-California state or local bonds on Schedule CA (540 or 540NR), line 8, column C.   |
| <ul style="list-style-type: none"> <li>Loans made to a business located in an enterprise zone (EZ)</li> </ul>  | Federal law does not allow a deduction for net interest income from loans made to a business located in an enterprise zone. California law permits a deduction for the net interest income to a business located in an enterprise zone.   | Use form FTB 3805Z, Enterprise Zone Deduction and Credit Summary. Transfer the net interest deduction from form FTB 3805Z to Schedule CA (540 or 540NR), line 8, column B. Write "FTB 3805Z" next to the dotted line on Form 540 or Form 540NR, line 14. |
| <b>Dividend Income</b>   |   |  |
| <ul style="list-style-type: none"> <li>Exempt interest dividends</li> </ul>  | Certain mutual funds are qualified to pay "exempt interest dividends" if at least 50% of their assets consist of tax-exempt government obligations.   | Enter the excess of the California exempt interest dividend over the federal exempt interest dividend on Schedule CA (540 or 540NR), line 9, column B.   |

| ITEM  | DIFFERENCES BETWEEN FEDERAL AND CALIFORNIA LAW  | WHAT TO DO FOR CALIFORNIA  |
|---|---|--|
| <ul style="list-style-type: none"> <li>Controlled foreign corporation (CFC)</li> <li>Regulated investment company (RIC)</li> <li>S corporation</li> <li>Distributions of pre-1987 earnings from S corporations</li> <li>Noncash patronage dividend from farmers' cooperatives or mutual associations</li> </ul>   | <p>California taxes CFC dividends in the year distributed rather than in the year earned.</p> <p>California taxes the undistributed capital gain from a RIC in the year distributed rather than in the year earned.</p> <p>Dividends from a federal S corporation that elects to be treated as a California C corporation are taxable to California.</p> <p>Prior to 1987, California treated all federal S corporations as C corporations. So when a federal S corporation first becomes a California S corporation, its initial accumulated adjustments account (AAA) has a zero balance regardless of the federal AAA balance. If distributions from the S corporation exceed the California balance in the AAA, you have a distribution from pre-1987 earnings.</p> <p>Federal law taxes the dividend in the year of receipt. California permits an election to include the dividend in gross income either when received or when redeemed. Once an election is made, this method must be followed unless a change in the method of reporting is approved by the Franchise Tax Board (FTB).</p>   | <p>Enter the amount of the CFC dividend on Schedule CA (540 or 540NR), line 9, column C.</p> <p>Enter the distribution on Schedule CA (540 or 540NR), line 9, column C.</p> <p>Enter the amount of the dividend on Schedule CA (540 or 540NR), line 9, column C.</p> <p>Enter distributions from pre-1987 earnings (or earnings in any later year that the corporation was a federal S corporation and a California C corporation) on Schedule CA (540 or 540NR), line 9, column C.</p> <p>If you elect to include the dividend in the year of receipt, no adjustment is required. If you elect or elected to include the dividend in the year redeemed, enter the amount received in 1999 on Schedule CA (540 or 540NR), line 9, column B. Enter the amount redeemed in 1999 on Schedule CA (540 or 540NR), line 9, column C.</p>   |
| <b>State Tax Refund</b>   |   |  |
| <ul style="list-style-type: none"> <li>State income tax refund</li> </ul>   | <p>Federal law includes the state income tax refund in income. California excludes the state income tax refund from income.</p>   | <p>Enter the amount of state income tax refund included in federal income on Schedule CA (540 or 540NR), line 10, column B.</p>  |
| <b>Alimony Received</b>   |   |  |
| <ul style="list-style-type: none"> <li>Alimony received by a nonresident alien</li> </ul>   | <p>Alimony which was not included on the federal return must be included on the California return.</p>  | <p>Enter the amount not included in federal income on Schedule CA (540 or 540NR), line 11, column C.</p>   |
| <b>Business Income or (Loss) — Depreciation, Amortization, and Property Expensing</b>   |   |  |
| <ul style="list-style-type: none"> <li>Income from a business, trade, or profession conducted partially in California</li> <li>Asset expense election (IRC Section 179)</li> <li>MACRS recovery period for nonresidential real property</li> <li>Depreciation of assets acquired prior to 1/1/87</li> <li>Amortization of goodwill and certain other intangibles</li> <li>Business property moves into California</li> <li>Enterprise zone, Local Agency Military Base Recovery Area (LAMBRA), or Targeted Tax Area (TTA) business expense deduction</li> </ul> | <p>If a nonresident owns a business, trade, or profession carried on within California that is an integral part of a unitary business carried on both within and outside California, the amount of such income having its source in California is determined in accordance with the provisions of the Uniform Division of Income for Tax Purposes Act.</p> <p>Federal law allows an expense election up to \$19,000 of the cost of certain business property in lieu of depreciation. California and federal law are the same.</p> <p>For federal purposes, the recovery period for depreciation of nonresidential real property increased from 31.5 years to 39 years. California did not conform to this provision until 1/1/97. The California recovery period of 31.5 years should continue to be used for property placed in service on or after 5/13/93 and before 1/1/97.</p> <p>Federal law allowed the rapid write-off of tangible personal property and buildings over recovery periods which were shorter than economic useful lives under the Accelerated Cost Recovery System (ACRS). California law in general was not conformed to federal law but did allow ACRS for certain residential rental property constructed in California on or after 7/1/85 and before 1/1/87.</p> <p>Property classified as IRC Section 197 property under federal law is also Section 197 property for California purposes. However, for Section 197 property acquired before 1/1/94, the California basis as of 1/1/94 must be amortized over the remaining federal amortization period.</p> <p>Depreciation methods and useful lives of trade or business property must be acceptable to California.</p> <p>Federal law has no comparable deduction. A California enterprise zone business may elect to immediately expense up to \$40,000 (depending on the year of designation) of the cost of qualified property. A California LAMBRA business may elect to immediately expense up to \$40,000 (depending on the year of designation) of the cost of qualified property. A California Targeted Tax Area (TTA) business may elect to immediately expense up to \$40,000 (depending on the year of designation) of the cost of qualified property. For California purposes, you may not take an IRC Section 179 deduction on any asset used to calculate the business expense deduction.</p> | <p>Gross income from the entire business, trade, or profession is included in the nonresident's adjusted gross income from all sources. The nonresident's California source business income is generally determined by a 4-factor apportionment formula (property, payroll, and sales). Refer to Title 18, Cal. Code Reg. Section 17951.</p> <p>Use form FTB 3885A to figure the necessary adjustment to make on Schedule CA (540 or 540NR) only if you make a different election for California.</p> <p>Use form FTB 3885A to figure the depreciation adjustment to make on Schedule CA (540 or 540NR).</p> <p>Use form FTB 3885A to figure the adjustment to make on Schedule CA (540 or 540NR).</p> <p>Use form FTB 3885A to figure the adjustment to make on Schedule CA (540 or 540NR).</p> <p>If an unacceptable method was used before the move into California, use the straight-line method to compute the basis in the property.</p> <p>Use form FTB 3805Z, form FTB 3807, or form FTB 3809. Enter the business expense deduction from form FTB 3805Z, form FTB 3807, or form FTB 3809 on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column B. Use form FTB 3885A to figure any depreciation adjustment to make on Schedule CA (540 or 540NR). <b>Note for enterprise zone assets:</b> Beginning in 1997, any remaining basis of enterprise zone assets for which the enterprise zone business expense deduction is taken may not be depreciated until the taxable year following the taxable year in which the deduction has been taken.</p> |

| ITEM  | DIFFERENCES BETWEEN FEDERAL AND CALIFORNIA LAW   | WHAT TO DO FOR CALIFORNIA   |
|---|--|---|
| <ul style="list-style-type: none"> <li>Accelerated depreciation for property on Indian reservations</li> </ul>  | Under federal law, certain property on Indian reservations placed in service after 1/1/94 and before 12/31/2003 will be subject to special MACRS recovery periods that permit faster write-off of property. California did not conform to this provision.  | Use form FTB 3885A to figure the depreciation adjustment to make on Schedule CA (540 or 540NR).   |
| <ul style="list-style-type: none"> <li>Pollution control facilities</li> </ul>  | Both California and federal law provide for accelerated write-off of pollution control facilities. California law only allows the write-off of facilities located in California.   | Enter the amortization for the California facilities on form FTB 3885A. Compare the California amortization to the federal amortization and enter the difference on Schedule CA (540 or 540NR), line 12 or line 17, column C.   |
| <ul style="list-style-type: none"> <li>Expenditure for tertiary injectants incurred in the crude oil industry</li> </ul>  | Federal law allows a deduction for the cost of tertiary injectants which are part of a tertiary recovery system. California law allows a depreciation deduction if the tertiary injectant qualifies as property used in a trade or business or is held for the production of income.   | Enter the amount of tertiary injectants deducted on your federal return on Schedule CA (540 or 540NR), line 12, column C. Attach a schedule reflecting the depreciation computation of tertiary injectants placed in service during 1999. Then complete form FTB 3885A.                                       |
| <ul style="list-style-type: none"> <li>Adjustments for reduced recovery periods for fruit bearing grapevines replaced in a California vineyard on or after 1/1/92, as a result of phylloxera infestation on or after 1/1/97, as a result of Pierce's disease</li> </ul> | Federal law generally requires a 10-year recovery period for fruit bearing vines for purposes of accelerated cost recovery and a 20-year recovery period for those vines under an alternative depreciation system. California law allows 5 and 10-year recovery periods, respectively.   | Prepare a schedule reflecting the depreciation computation of grapevines placed in service on or after 1/1/92 (for phylloxera infestation) and placed in service on or after 1/1/97 (for Pierce's disease). Then complete form FTB 3885A and attach it and your depreciation schedule to your return.         |
| <ul style="list-style-type: none"> <li>Water utility property</li> </ul>  | Under federal law, water utility property that is an integral part of the gathering, treatment, or commercial distribution of water and would otherwise have had a 20-year recovery period and any municipal sewer, will be depreciated over 25 years. The increased recovery period applies to property placed in service after 6/12/96, other than property placed in service under a binding contract in effect before 6/10/96. California does not conform to this provision and you must continue to use a 20-year recovery period. | Use form FTB 3885A to figure the depreciation adjustment to enter on Schedule CA (540 or 540NR).  |
| <ul style="list-style-type: none"> <li>Income forecast method of depreciation</li> </ul>  | For assets placed in service after 8/5/97, federal law limits the income forecast method of depreciation to film, video tape, sound recordings, copyrights, books, patents, and other property to be specified by federal regulations. California conformed to this limitation for assets placed in service after 12/31/97.  | Use form FTB 3885A to figure the depreciation adjustment to enter on Schedule CA (540 or 540NR).  |
| <ul style="list-style-type: none"> <li>Clean fuel and electric vehicles classified as luxury automobiles</li> </ul>   | For electric vehicles and automobiles equipped to qualify as clean-burning fuel vehicles placed in service after 8/5/97 and before 1/1/2005, federal law allows a modified depreciation limitation equivalent to triple the IRC Section 280F limitation for other luxury automobiles. California conformed to this provision for assets placed in service after 12/31/97.  | Use form FTB 3885A to figure the depreciation adjustment to enter on Schedule CA (540 or 540NR).  |
| <b>Business Income or (Loss) — Adjustments to Basis or Business Deductions</b>  |  |   |
| <ul style="list-style-type: none"> <li>Donated agricultural products transportation credit</li> </ul>   | Federal law has no comparable credit. Under California law, deductions are not allowed for the portion of expenses equal to the credit.  | Enter on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column C, the portion of the deduction claimed on your federal return that was used to claim the California credit.  |
| <ul style="list-style-type: none"> <li>Farmworker housing credit</li> </ul>   | Federal law has no comparable credit. Under California law, deductions are not allowed for the portion of expenses equal to the credit.  | Enter on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column C, the portion of the deduction claimed on your federal return that was used to claim the California credit.  |
| <ul style="list-style-type: none"> <li>Rice straw credit</li> </ul>   | Federal law has no comparable credit. Under California law, deductions are not allowed for the portion of expenses equal to the credit.  | Enter on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column C, the portion of the deduction claimed on your federal return that was used to claim the California credit.  |
| <ul style="list-style-type: none"> <li>Clean fuel vehicles and refueling property</li> </ul>  | The deduction for clean fuel vehicles and refueling property is not applicable for tax years beginning on or after 1/1/95.   | Enter the amount deducted from federal income on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column C. Then complete form FTB 3885A.  |
| <ul style="list-style-type: none"> <li>Basis adjustment for sales or use tax credit for property used in an enterprise zone, a LAMBRA, the Targeted Tax Area (TTA), or the former LARZ.</li> </ul>  | Federal law has no comparable credit, but IRC Section 164(a) requires an increase in basis for the amount of sales or use tax paid. Under California law, depreciation is computed based on cost, without regard to the sales or use tax allowed as a credit. Federal and state basis will differ due to the increase in federal basis by the addition of the sales or use tax.  | Use form FTB 3805Z, form FTB 3807, form FTB 3809, or form FTB 3806 to claim the sales or use tax credit for property used in an enterprise zone, a LAMBRA, the TTA, or the former LARZ. Complete form FTB 3885A, Part III if you are depreciating the cost of the property in excess of the allowable credit. |
| <ul style="list-style-type: none"> <li>Credit for employer-paid child care center and services</li> </ul>   | Federal law allows a deduction for all ordinary and necessary trade or business expenses. Under California law, employers may claim a credit for establishing a child care program or contributing to a child care referral service. Deductions are not allowed for that portion of expenses equal to the credit. Reduce the basis of any child care facility by the amount of the credit attributable to the facility in the year the credit is allowed.  | Enter 30% of the amount of deductions claimed on your federal return to operate a child care program or contribute to the referral service on Schedule CA (540 or 540NR), line 12, column C. Then complete form FTB 3885A.  |

| ITEM   | DIFFERENCES BETWEEN FEDERAL AND CALIFORNIA LAW  | WHAT TO DO FOR CALIFORNIA   |
|--|---|---|
| <ul style="list-style-type: none"> <li>Credit for employer-paid child care plan</li> </ul>   | Federal law allows a deduction for all ordinary and necessary trade or business expenses. Under California law, employers and building owners may claim a credit of 30% of contributions to a qualified care plan on behalf of any dependent under the age of 12 of the employer's California employee. Deductions are not allowed for that portion of the expenses equal to the amount of the credit. If the contribution to the plan is used at a facility owned by the employer, the basis of the facility must be reduced by the amount of the credit attributable to the facility in the year the credit is allowed. | Enter 30% of the amount of deductions claimed on your federal return for costs paid for contributions to a qualified care plan made on behalf of a California employee's dependent(s) under the age of 12 on Schedule CA (540 or 540NR), line 12, column C. Then complete form FTB 3885A.   |
| <ul style="list-style-type: none"> <li>Enhanced oil recovery credit</li> </ul>   | Federal law allows a credit for up to 15% of qualified costs attributable to qualified enhanced recovery oil projects. The basis of the enhanced recovery oil projects must be reduced by the amount of the credit. California conforms to this provision, except that only California projects qualify for the state credit.   | Get form FTB 3546, Enhanced Oil Recovery Credit.  |
| <ul style="list-style-type: none"> <li>Disabled access credit for eligible small businesses</li> </ul>   | Federal law allows a credit of 50% for the cost of making a business accessible to disabled individuals. No deduction is permitted for any amount for which a disabled access credit is allowed. California conforms to this provision, but the maximum credit is \$125 (50% of eligible expenses up to \$250).   | Get form FTB 3548, Disabled Access Credit for Eligible Small Businesses.  |
| <ul style="list-style-type: none"> <li>Indian employment credit</li> </ul>   | Under federal law, a nonrefundable credit is available to employers for certain wages and health insurance costs paid or incurred by the employer after 1/1/94 for certain full-time or part-time employees who also are enrolled members of an Indian tribe or are spouses of enrolled members. California did not conform to this provision.  | Enter the amount of business expense denied under federal law on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column B.  |
| <ul style="list-style-type: none"> <li>Abandonment or tax recoupment fees for open-space easements and timberland preserves</li> </ul>   | Federal law allows a deduction for expenses incurred in a trade or business or held for the production of income. California denies a deduction for fees paid by California property owners on termination of open-space easements or timberland preserve status.   | Enter the amount of fees incurred and deducted on your federal return on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column C.  |
| <ul style="list-style-type: none"> <li>Enterprise zone, LAMBRA, or Manufacturing Enhancement Area (MEA) hiring credit</li> </ul>   | Federal law allows a deduction for all ordinary and necessary trade or business expenses. Under California law, employers may claim a hiring credit related to an enterprise zone, a LAMBRA, or an MEA. Deductions for the wages upon which the credit is based must be reduced by the amount of credit.  | Enter the amount of wages (from form FTB 3805Z, form FTB 3807, or form FTB 3808) equal to the amount of your California credit on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column C.   |
| <ul style="list-style-type: none"> <li>Club dues or payments made to a club which restricts membership or the use of its services or facilities on the basis of age, sex, race, religion, color, ancestry, or national origin</li> </ul> | Federal law does not allow a deduction for dues paid or incurred for all types of club memberships, including airline and hotel clubs, after 12/31/93. California law does not have a similar provision. California does not allow any payments whether for dues, goods, or services made to a club which restricts membership or the use of its services or facilities on the basis of age, sex, race, religion, color, ancestry, or national origin.  | Enter the amount of qualifying club dues on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column B. If you made payments for goods or services to a club that discriminates and deducted them on your federal return, enter the amount of the payments on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column C. |
| <ul style="list-style-type: none"> <li>Real Estate Professionals – Material participation in a rental real estate activity</li> </ul>  | Beginning with the 1994 tax year and for federal purposes only, rental real estate activities conducted by persons in a real property business are not automatically treated as passive activities. California did not conform to this provision and these activities are still considered passive under California law.  | To figure the adjustment to make on Schedule CA (540 or 540NR), line 17, use form FTB 3801 and include these activities when completing the California Worksheet and the California Adjustment Worksheet in the instructions for form FTB 3801.   |
| <ul style="list-style-type: none"> <li>Research credit</li> </ul>  | Federal law allows a credit for research expenses and requires that the deduction for research expenses be reduced by the amount of the credit allowed. California conforms to federal law, but requires the amount of research expenses to be reduced by the amount of the California credit. In addition, California law requires the use of the California tax bracket when determining the elective credit amount.  | Enter the amount of research expenses deducted on your federal return on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column C. Enter the amount of California research expenses after reduction for California research credit on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column B.                       |
| <ul style="list-style-type: none"> <li>Denial of deduction for lobbying expenses</li> </ul>  | Federal law prohibits any deduction under IRC Section 162 for amounts paid or incurred in connection with: 1) influencing federal or state legislation, or 2) any communication with certain covered federal executive branch officials to influence their official actions or positions. California law specifically allows the deduction of such expenses incurred in carrying on any trade or business.  | Enter the amount of lobbying expenses prohibited by federal law on your California return on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column B.  |
| <ul style="list-style-type: none"> <li>Property for which a public utility provided an energy conservation subsidy on or after 1/1/95 and before 1/1/97</li> </ul>   | Federal law allows an exclusion from income for any subsidy provided directly or indirectly by a public utility for the purchase or installation of any energy conservation measure with respect to a dwelling unit (house, apartment, condominium, mobile home, boat, or similar property). The adjusted basis of the property must be reduced by the amount excluded from income. California does not conform for amounts received after 12/31/94 and before 1/1/97.  | Complete form FTB 3885A.  |
| <ul style="list-style-type: none"> <li>Employer wage expenses for work opportunity credit and welfare-to-work credit</li> </ul>  | Federal law allows a work opportunity credit and a welfare-to-work credit for employers that hire individuals from certain target groups and recipients of long-term family assistance. Employers that claim these credits must reduce their wage expense by the amount of the credits. California has no similar credits.  | Enter the amount of the federal work opportunity credit or welfare-to-work credit that reduced the federal deduction for wages on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column B.   |

| ITEM   | DIFFERENCES BETWEEN FEDERAL AND CALIFORNIA LAW  | WHAT TO DO FOR CALIFORNIA  |
|--|---|--|
| <ul style="list-style-type: none"> <li>Qualified clinical testing expenses</li> </ul>  | Federal law allows an orphan drug credit for qualified clinical testing expenses incurred in testing drugs for rare diseases or conditions. A business must reduce its deduction for qualified clinical testing expenses by the amount of the credit. California has no similar credit.   | Enter the amount of the federal orphan drug credit that reduced the federal deduction for qualified clinical testing expenses on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column B.   |
| <ul style="list-style-type: none"> <li>Qualified environmental cleanup costs</li> </ul>  | Federal law allows an election to currently deduct costs paid or incurred on or after 8/5/97, for cleanup costs such as remediation of certain hazardous substances at a qualified contaminated site. California did not conform to this provision until 1/1/98. Therefore, before 1/1/98, such costs were classified as capital expenditures for California purposes.  | Use form FTB 3885A to figure the adjustment to enter on Schedule CA (540 or 540NR).  |
| <ul style="list-style-type: none"> <li>Job-site meals provided to more than 50% (but less than 100%) of employees</li> </ul>   | Federal law allows employers to deduct the cost of meals provided to employees at the job site for the employer's convenience solely because the meals were provided to more than 50% (but less than 100%) of employees. California has not conformed to the provision that allows the deduction solely because the meals were provided to more than 50% of the employees.  | Enter on Schedule CA (540 or 540NR), line 12, line 17, or line 18, column C, the cost of meals that were deducted on your federal return solely because the meals were provided to more than 50% of your employees.  |
| <b>Capital Gains and Losses</b>  |   |  |
| <ul style="list-style-type: none"> <li>Gain on sale or disposition of a qualified assisted housing development to low-income residents or to specified entities who maintain housing for low-income residents</li> </ul> | Federal law does not allow special treatment on gains related to the sale of certain assisted housing. California law permits the deferral of such gain, under certain conditions, if the proceeds are reinvested in residential real property (other than a personal residence) within two years of the sale.  | Enter the transaction on California Schedule D, line 1 and in column (e) enter "-0- R&TC Section 18041.5." Reduce the basis of replacement property by the gain deferred. Attach a schedule to your return reflecting computation of basis in the replacement property, or a statement of intent to replace within the replacement period. |
| <ul style="list-style-type: none"> <li>Gain on sale of personal residence</li> </ul>   | For sale or exchanges after 5/6/97, federal law allows an exclusion of gain on the sale of a personal residence in the amount of \$250,000 (\$500,000 if married filing joint). The taxpayer must have owned and occupied the residence as a principal residence for at least 2 of the 5 years before the sale. California conforms to this provision. However, taxpayers who served in the Peace Corps during the 5 year period ending on the date of the sale may reduce the 2 year period by the period of service, not to exceed 18 months. Also, federal gain on the sale of a personal residence may differ from the California gain due to differences in the amount of depreciation allowed or allowable. | Report gain on the sale of a personal residence on California Schedule D, line 1, column (e). Cost or other basis plus expense of sale must reflect adjustment for depreciation allowed or allowable for California purposes.  |
| <ul style="list-style-type: none"> <li>Undistributed capital gains for regulated investment company (RIC) shareholders</li> </ul>  | Federal law requires certain undistributed capital gains reported on federal Form 2439 to be included in the gross income of the mutual fund shareholder and allows a tax credit for the capital gains tax paid by the RIC. California has no similar provision.  | Do not enter the amount of undistributed capital gains on California Schedule D.   |
| <ul style="list-style-type: none"> <li>Gain or loss on sale of property inherited before 1/1/87</li> </ul>   | Federal gain or loss may differ from the California gain or loss due to differences in the basis of property. For more information, get FTB Pub. 1039, Basis of Property-Decedent and Surviving Spouse. For property inherited after 1/1/87, the California basis and the federal basis are the same.   | Report the amount of California capital gains and losses on California Schedule D.   |
| <ul style="list-style-type: none"> <li>Capital loss carrybacks</li> </ul>  | Federal law allows a deduction for carrybacks of certain capital losses. California has no similar provision.   | Report the amount of California capital gains and losses on California Schedule D.   |
| <ul style="list-style-type: none"> <li>Exclusion of gain on the sale of qualified small business stock</li> </ul>  | Federal law allows an exclusion under IRC Section 1202 of 50% of the gain on the sale of qualifying small business stock originally issued after 8/10/93, that was held for more than five years. California law provides a similar exclusion (under R&TC Section 18152.5); however, for California purposes, 80% of the issuing corporation's payroll must be attributable to employment located within California, and at least 80% of the value of the issuing corporation's assets must be used by the corporation to actively conduct one or more qualified trades or businesses in California.  | Use California Schedule D if you claim the federal IRC Section 1202 exclusion on your federal return.  |
| <ul style="list-style-type: none"> <li>Rollover of gain from the sale of qualified small business stock</li> </ul>   | Federal law permits an election for a tax-free rollover of capital gain from the sale of qualified small business stock occurring after 8/5/97, that is held for more than 6 months, if the proceeds are used to purchase other qualified small business stock within 60 days of the sale. California generally conforms to this provision; however, California does not conform to the technical change made by the federal IRS Restructuring and Reform Act of 1998 which allows a pass-through entity to pass through the exclusion to a partner, member, or shareholder.  | If you have an interest in a pass-through entity, refer to column (c) Adjustments, "Capital gains and losses" on your Schedule K-1 (565, 568, or 100S) from the entity.  |
| <b>Other Gains or Losses</b>   |   |  |
| <ul style="list-style-type: none"> <li>Basis differences of business property</li> </ul>   | The California basis of assets may be different than the federal basis due to differences between California and federal law, which may affect the gain or loss on disposition.   | Get Schedule D-1, Sales of Business Property, to figure the adjustment to make on Schedule CA (540 or 540NR).  |

| ITEM   | DIFFERENCES BETWEEN FEDERAL AND CALIFORNIA LAW   | WHAT TO DO FOR CALIFORNIA  |
|--|--|--|
| <b>IRA Distribution</b>  |  |  |
| <ul style="list-style-type: none"> <li>IRA basis adjustments</li> </ul>  | There may be differences in the taxable amount of the distribution depending on when the contributions were made, if you changed residency status after you first began making contributions to your IRA or made different deductions for California because of differences between your California and federal self-employment income.  | Get FTB Pub. 1005, Pension and Annuity Guidelines, for more information.   |
| <ul style="list-style-type: none"> <li>Roth IRAs</li> </ul>  | Federal law and California law are the same regarding contributions, conversions, and distributions. However, the taxable amount of a distribution may not be the same because of basis differences.   | Get FTB Pub. 1005, Pension and Annuity Guidelines, for more information.   |
| <b>Pensions and Annuities</b>  |  |  |
| <ul style="list-style-type: none"> <li>Railroad retirement benefits</li> </ul>   | California does not tax railroad retirement benefits reported on federal Form RRB 1099-R.  | Enter on Schedule CA (540 or 540NR), line 16, column B, the amount of railroad retirement benefits included in adjusted gross income on your federal return.   |
| <ul style="list-style-type: none"> <li>Employer-sponsored pensions and annuities (for annuity starting dates after 7/1/86 and before 1/1/87) if you elected to use the "three-year rule" for California</li> </ul> | Under federal law, no "three-year rule" is allowed for any individual whose annuity starting date is after 7/1/86. Under California law, an individual whose annuity starting date is after 7/1/86 and before 1/1/87 may elect to use the "three-year rule" if: 1) the employer paid part of the cost and 2) during the three years from the date of the first annuity payment, the total amount receivable will equal or exceed the cost (investment) in the contract. No amounts received are taxed until the cost is recovered.                           | If your annuity starting date was after 7/1/86 and before 1/1/87, AND you elected to use the three-year recovery rule for California, an adjustment is required. The adjustment must be computed by comparing the amount of pensions and annuities included on your federal return with the amount taxable by California. Enter the difference on Schedule CA (540 or 540NR), line 16, column C. Get FTB Pub. 1005, Pension and Annuity Guidelines, for more information.  |
| <b>Unemployment Compensation</b>   |  |  |
| <ul style="list-style-type: none"> <li>Unemployment compensation</li> </ul>  | California does not tax unemployment compensation.   | Enter on Schedule CA (540 or 540NR), line 19, column B, the amount of unemployment compensation you included in adjusted gross income on your federal return.  |
| <b>Social Security Benefits</b>  |  |  |
| <ul style="list-style-type: none"> <li>Social security benefits and equivalent tier 1 railroad retirement benefits</li> </ul>  | California does not tax social security benefits and equivalent tier 1 railroad retirement benefits.   | Enter on Schedule CA (540 or 540NR), line 20, column B, the amount of social security benefits and equivalent tier 1 railroad retirement benefits you included in adjusted gross income on your federal return.  |
| <b>Rents, Royalties, Partnerships, Estates, Trusts, etc.</b>   |  |  |
| <ul style="list-style-type: none"> <li>Income or loss from a federal S corporation that is a California C corporation</li> </ul>   | Where a corporation has elected S status for federal purposes but elects to retain C status for California, income or loss from such a corporation is included in gross income on the shareholder's federal return, but is not included on the California return. For federal purposes, distributions from an S corporation reduce basis in the stock or are treated as capital gain or as dividends. For California purposes, distributions from a C corporation are taxed as dividend income, or reduce basis in the stock or are treated as capital gain. | If you reduced the basis of S corporation stock on your federal return, you must determine whether the distributions were income for California purposes and report them accordingly. If you reported income on federal Schedule E from an S corporation that is a California C corporation, enter the amount of such income on Schedule CA (540 or 540NR), line 17, column B. If you reported a loss from such a corporation, enter the amount of the loss deducted on your federal return on Schedule CA (540 or 540NR), line 17, column C. Enter the amount of taxable distributions on Schedule CA (540 or 540NR), line 9, column C. |
| <ul style="list-style-type: none"> <li>Pass-through of income and deductions from partnerships, S corporations, estates, and trusts</li> </ul>   | Items of income and deduction from pass-through entities may differ due to various differences between federal and state law. Refer to federal Schedule K-1, or Schedule Q in the case of REMICs, to determine items of income and deduction for federal purposes. Refer to California Schedule K-1 (100S, 541, 565 or 568) to determine items of income and deduction from pass-through entities for California purposes.   | Follow the instructions for Schedule K-1 (100S, 541, 565 or 568). Some items are reported directly on Schedule CA (540 or 540NR), line 17, and some items must be reported on other forms and schedules.   |
| <ul style="list-style-type: none"> <li>Accumulation distribution to beneficiaries on which the required California taxes have not been paid by a trust</li> </ul>  | Federal law taxes the accumulated income of a trust under IRC Sections 665-668. If a trust has a California resident trustee or beneficiary, the beneficiary is non-contingent, and the trust has not filed a California return and paid California tax as the income was accumulated, then the full amount of the accumulation distribution is taxable to the beneficiary in the year the accumulation distribution is received.  | If you received a federal Schedule J (1041) and did not receive a California Schedule J (541), an adjustment is required because the trust did not file a California return and pay the tax as the income was accumulated. The accumulation distribution from federal Schedule J (1041) must be adjusted for California purposes. This information must be provided by the trustee.  |
| <ul style="list-style-type: none"> <li>Accumulation distribution to beneficiaries on which the trust was not required to pay California tax because the beneficiaries' interest was contingent</li> </ul>          | Federal law taxes the accumulated income of a trust under IRC Sections 665-668. If a trust has a California resident trustee or beneficiary, the beneficiary is contingent, and the trust has not filed a California return and paid California tax as the income was accumulated, then the beneficiary is entitled to the benefit of income averaging under the provisions of R&TC Sections 17745(b) and (d).   | Use California form FTB 5870A, Tax on Accumulation Distribution of Trusts to compute the part of the accumulation distribution includable in your 1999 California adjusted gross income.   |

| ITEM   | DIFFERENCES BETWEEN FEDERAL AND CALIFORNIA LAW  | WHAT TO DO FOR CALIFORNIA   |
|--|---|---|
| <ul style="list-style-type: none"> <li>Amounts included in gross income of United States shareholders from foreign corporations</li> </ul>   | Under federal law (IRC Section 951), if a foreign corporation is a controlled foreign corporation (CFC) for an uninterrupted period of 30 days or more during any taxable year, then U.S. shareholders who own stock in a CFC on the last day of the taxable year in which it was a CFC must include in gross income their pro rata share of income. The pro rata shares are included in the income of U.S. shareholders even though there may be intervening entities in a chain between a CFC and such shareholders. California has no similar provision.   | Enter the amount of income received from a CFC and included in federal income on Schedule CA (540 or 540NR), line 17, column B.   |
| <b>Other Income</b>  |   |   |
| <ul style="list-style-type: none"> <li>Net Operating Loss (NOL)               <ol style="list-style-type: none"> <li>Disaster loss carryover</li> <li>Federal NOL deduction</li> <li>California NOL carryover</li> <li>NOL deduction from enterprise zones, LAMBRAs, the TTA, or the former LARZ</li> </ol> </li> <li>Original issue discount (OID) for debt instruments issued (and loans made) in 1985 and 1986</li> </ul> | <p>The allowable California disaster loss carryover under California law is different than the allowable disaster loss carryover under federal law.</p> <p>Due to differences between federal and California law, you must refigure your NOL deduction for California purposes. You may be required to elect specific NOL characterization for California which may exclude from consideration other realized losses.</p> <p>The allowable NOL carryover under California law is different than the allowable NOL carryover under federal law. There is no NOL carryback under California law.</p> <p>Federal law has no comparable deduction.</p> <p>In the tax year in which the debt instrument matures, is sold, exchanged, or otherwise disposed of, you must recognize the difference between the amount reported on your federal return and the amount reported for California purposes.</p> | <p>Enter as a positive number on Schedule CA (540 or 540NR), line 21b, column B, from your 1998 form FTB 3805V.</p> <p>Enter as a positive number on Schedule CA (540 or 540NR), line 21c, column C, the federal NOL deduction. Use form FTB 3805V to figure the allowable California NOL deduction.</p> <p>Use form FTB 3805V to figure the allowable California NOL deduction and enter the result as a positive number on Schedule CA (540 or 540NR), line 21d, column B.</p> <p>Use form FTB 3805Z, form FTB 3807, form FTB 3809, or form FTB 3806 to figure the NOL deduction.</p> |
| <ul style="list-style-type: none"> <li>Income exempted by U.S. tax treaties</li> </ul>   | California is not affected by U.S. treaties with foreign countries unless they specifically apply to state income taxes. If a treaty does not specifically exempt income from state income tax, California requires the reporting of adjusted gross income from all sources.  | <b>Issuer (debtor)</b> – Enter the difference between the federal deductible amount and the California deductible amount on Schedule CA (540 or 540NR), line 21f, column B.   |
| <ul style="list-style-type: none"> <li>Foreign income of nonresident aliens</li> </ul>   | Federal Form 1040NR, U.S. Nonresident Alien Income Tax Return, and federal Form 1040NR-EZ, U.S. Income Tax Return for Certain Nonresident Aliens With No Dependents, requires that only United States source income be reported. California requires the reporting of adjusted gross income from all sources.   | <b>Holder (lender)</b> – Enter the difference between the amount included in federal gross income and the amount included for California purposes on Schedule CA (540 or 540NR), line 21f, column C.  |
| <ul style="list-style-type: none"> <li>California lottery winnings</li> </ul>  | California does not tax California lottery winnings. California does tax lottery winnings from other states.  | Adjust federal income to reflect worldwide income computed under California statutes. Enter losses from foreign sources on Schedule CA (540 or 540NR), line 21f, column B. Enter foreign source income on Schedule CA (540 or 540NR), line 21f, column C.   |
| <ul style="list-style-type: none"> <li>Reward from a crime hotline</li> </ul>  | California does not tax a reward authorized by a government agency and received from a crime hotline established by a government agency or nonprofit organization.  | Adjust federal income to reflect worldwide income computed under California statutes. Enter losses from foreign sources on Schedule CA (540 or 540NR), line 21f, column B. Enter foreign source income on Schedule CA (540 or 540NR), line 21f, column C.   |
| <ul style="list-style-type: none"> <li>Income received from a recycling center or location for empty beverage containers</li> </ul>  | Federal law taxes beverage container recycling income. California law does not tax income received by a consumer for recycling empty beverage containers.   | Enter on Schedule CA (540 or 540NR), line 21a, column B, the amount of California lottery winnings included in adjusted gross income on your federal return.  |
| <ul style="list-style-type: none"> <li>Rebates from water agencies or suppliers</li> </ul>   | Federal law taxes rebates received from water agencies or suppliers. California law does not tax those rebates.   | Enter on Schedule CA (540 or 540NR), line 21f, column B, the amount of such a reward you included in adjusted gross income on your federal return.  |
| <ul style="list-style-type: none"> <li>Foreign-earned income and housing expense exclusion</li> </ul>  | Under federal law (IRC Section 911), a qualified individual may elect to exclude certain foreign-earned income and an employer-provided housing allowance. California has no similar provision.   | Enter the amount of beverage container recycling income reported on your federal return on Schedule CA (540 or 540NR), line 21f, column B.  |
| <ul style="list-style-type: none"> <li>Qualified prizes with cash options</li> </ul>   | Federal law provides that a prize winner who is provided an option to choose, within 60 days after becoming entitled to the prize, either a single cash payment or an annuity, is not required to include the prize in income merely by reason of having an option. California law requires that a contest winner who is given the option of receiving a single cash payment or annuity is required to include the value of the award in income even if the annuity option is chosen.   | Enter the amount of rebate received from water agencies or suppliers and included in federal income on Schedule CA (540 or 540NR), line 21f, column B.  |
|  |   | Enter the amount of foreign-earned income and housing allowance under IRC Section 911 on Schedule CA (540 or 540NR), line 21f, column C.  |
|  |   | Enter on Schedule CA (540 or 540NR), line 21f, column C, the amount not included on your 1999 federal return. Later when you include the prize in federal income, you will be able to exclude it from California income.  |

| ITEM   | DIFFERENCES BETWEEN FEDERAL<br>AND CALIFORNIA LAW   | WHAT TO DO<br>FOR CALIFORNIA   |
|--|---|--|
| <ul style="list-style-type: none"> <li>Refinancing of certain student loans</li> </ul>   | <p>Federal law allows an exclusion from gross income for refinancing of existing student loans after 8/5/97, on loans made by certain tax-exempt organizations if the debtor worked for a certain period of time in a designated profession for any of a broad class of employers. In general, California conforms to this provision regarding the refinancing of student loans; however, California allows the exclusion only for loans made by educational organizations, and does not conform to the requirement that the refinancing must be made under a program of refinancing that requires the student to fulfill a supervised public service requirement.</p>  | <p>For amounts excluded from federal income due to the refinancing of student loans where the loan is made by an organization other than an educational organization, enter the amount of refinanced debt excluded on your federal return on Schedule CA (540 or 540NR), line 21f, column C.</p>   |
| <b>Adjustments to Income</b>   |   |  |
| <ul style="list-style-type: none"> <li>Alimony paid by a nonresident alien</li> </ul>  | <p>Alimony expense paid by a nonresident alien that was not deducted on the federal return is a deduction on the California return.</p>   | <p>Enter the amount not included on your federal return on Schedule CA (540 or 540NR), line 31a, column C.</p>   |
| <b>Itemized Deductions</b>   |   |  |
| <ul style="list-style-type: none"> <li>Taxes               <ol style="list-style-type: none"> <li>Minimum tax paid by a limited partnership</li> <li>Franchise tax or income taxes paid by an S corporation</li> <li>State, local, and foreign income taxes paid</li> <li>Other adjustments</li> </ol> </li> </ul> | <p>Federal law allows a deduction for franchise taxes. California specifically disallows this deduction.</p> <p>Federal law allows a deduction for franchise taxes or income taxes paid under the Bank and Corporation Tax Law. California specifically disallows this deduction.</p> <p>California does not allow a deduction for state, local, or foreign income taxes paid, including amounts paid for State Disability Insurance (SDI) or Voluntary Plan Disability Insurance (VPDI).</p> <p>Adjustments to itemized deductions include: adoption related expenses, mortgage interest credit, nontaxable income expense, employee business expense, investment interest expense, gambling losses, federal estate tax, generation skipping transfer tax, contribution of appreciated stock to a private foundation, state legislator's travel expense, casualty and theft losses for income-producing property, and prior year charitable contribution carryovers.</p> | <p>Add the amount of your federal deduction for franchise taxes paid to the amount on Schedule CA (540 or 540NR), line 36.</p> <p>Add the amount of your federal deduction for franchise taxes paid to the amount on Schedule CA (540 or 540NR), line 36.</p> <p>Add the amount of your federal deduction for state, local, and foreign taxes paid to the amount on Schedule CA (540 or 540NR), line 36.</p> <p>See Schedule CA (540 or 540NR), line 38, for more information.</p> |